

United States Court of Appeals

For the Ninth Circuit

WALTER TREPTE and MARGARET TREPTE,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF FOR THE PETITIONERS

GEORGE H. STONE,

1004 San Diego Trust & Savings Building,
San Diego 1, California,

Counsel for Petitioners.

WM. D. MORRISON,

821 First National Bank Building,
San Diego 1, California,

Counsel for Petitioners.

FILED

JAN 7 1949

PAUL R. O'BRIEN,
CLERK

United States Court of Appeals

For the Ninth Circuit

WALTER TREPTE and MARGARET TREPTE,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF FOR THE PETITIONERS

GEORGE H. STONE,
1004 San Diego Trust & Savings Building,
San Diego 1, California,
Counsel for Petitioners.

WM. D. MORRISON,
821 First National Bank Building,
San Diego 1, California,
Counsel for Petitioners.

Index

	Page
Opinion	1
Jurisdiction	1
Questions Involved	2
Code and Regulations Involved.....	3
Statement	3
Synopsis of Exhibits.....	4
Statement from Oral Evidence of:	
Walter B. Trepte.....	16
Albert Eugene Trepte.....	18
Margaret Trepte	19
Walter Trepte	20
Specifications of Errors Relied Upon.....	28
Summary of Argument.....	29
Argument:	
Petitioners are members of the Trepte Construc-	
tion Co., a co-partnership, and are entitled to	
have their individual income taxes computed on	
the basis of their share of the income of the co-	
partnership as provided for in Sections 181, 182,	
183, 187, and 3797 of the Internal Revenue Code	32
Appendix	45

Citations

Cases:

Allen v. Knott, 5 Cir., 166 F. 2d 798.....	40
Arnold v. Schepps, 5 Cir., 166 F. 2d 821.....	40
Canfield v. Commissioner, 6 Cir., 168 F. 2d 907	40

Citations (Continued)

Cases:	Page
Commissioner v. Tower, 327 U. S. 280.....	32, 33
Culbertson, W. O., Sr. and Gladys Culbertson v. Commissioner, 168 F. 2d 979.....	35, 40, 41
Doll v. Commissioner, 8 Cir., 149 F. 2d 239 (33 AFTR 1264)	40
Durwood v. Commissioner, 8 Cir., 159 F. 2d 400	40
Fischer, William F. v. Commissioner, 5 TC 507	41
Graham, B. W., 8 BTA 1081.....	33
Hammond, Ross B. v. J. W. Maloney, Collector of Internal Revenue, Fed. Sup. Vol. 80 No. 1, 212	41
Hartz v. Commissioner, 8 Cir., F. 2d (decided October 27, 1948).....	40
Iowa Bridge Co. v. Commissioner, 29 F. 2d 777..	39
Kent v. Commissioner, 6 Cir., F. 2d (decided Sept. 27, 1948).....	40
Kohl v. Commissioner, 8 Cir., F. 2d.....	40
Lawton v. Commissioner, 6 Cir., 164 F. 2d 380..	40
Lusthaus v. Commissioner, 327 U. S. 293.....	32
Meehan v. Valentine, 145 U. S. 611, 618, 36 L. Ed 835, 839, 12 S. Ct. 972.....	33
Runyon, Walter J. v. Commissioner, 8 TC 350..	41
Supornick v. Commissioner, 8 Cir., 150 F. 2d 110 (33 AFTR 1507).....	40

Citations (Continued)

Cases:	Page
Walsh, Thomas A., Jr. v. Commissioner of Internal Revenue, F. 2d (1948 Federal Tax Service, Prentice-Hall, Par. 72,635).....	39
Ward v. Thompson, 22 How (US) 330, 333, 334, 16 L. Ed 249-251.....	33
Weizer v. Commissioner, 6 Cir., 165 F. 2d 772....	40
Wilson v. Commissioner, 7 Cir., 161 F. 2d 661	40
Woosley v. Commissioner, 6 Cir., 168 F. 2d 330	40
Internal Revenue Code:	
Sec. 181—Partnership not taxable.....	2, 29, 32, 45
Sec. 182—Tax of Partners.....	2, 29, 32, 45
Sec. 183—Computation of Partnership Income.....	2, 29, 32, 45
Sec. 187—Partnership Returns.....	2, 29, 32, 46
Sec. 272—Procedure in General.....	2
Sec. 1141—Court of Review.....	2
Sec. 1142—Petition for Review.....	2
Sec. 3797—Definitions.....	2, 29, 32, 46
Miscellaneous:	
Treasury Regulations 111:	
Sec. 29.181-1—Partnerships	2, 47
Sec. 29.182-1—Distributive share of partners	2, 47
Sec. 29.183-1—Computation of partnership income	2, 48
Sec. 29.187-1—Partnership returns.....	2, 48
Civil Code 2466 of the State of California.....	13, 34

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH DISTRICT

No. 12078

WALTER TREPTE and MARGARET TREPTE,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE
Respondent.

ON PETITION FOR REVIEW OF THE
DECISION OF THE TAX COURT
OF THE UNITED STATES

BRIEF FOR THE PETITIONERS

Opinion of the Tax Court

The memorandum findings of fact and opinion of the Tax Court of the United States (Tr. 28-51) are not reported.

Jurisdiction

This petition for review (Tr. 54-64) involves United States income and victory taxes for the calendar years 1942 and 1943. On August 23, 1946, the Commissioner of Internal Revenue mailed to the taxpayers notices of deficiencies in the total amounts as follows:

	Years	Amount
Walter Trepte ----	1942-1943	\$23,183.84 (Tr. 4)
Margaret Trepte----	1942-1943	\$29,480.82 (Tr. 16)

Within ninety days thereafter and on November 18, 1946, the taxpayers filed their petitions with the Tax Court of the United States for a redetermination of those deficiencies under the provisions of Section 272 of the Internal Revenue Code. (Tr. 4-26). The decisions of the Tax Court sustaining the deficiencies were entered May 28, 1948. (Tr. 52, 53). The case is brought to this Court by a petition for review filed August 23, 1948 (Tr. 54-64), pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

Questions Involved

The questions involved are:

Whether the petitioners are entitled to have their individual Income and Victory Taxes computed for the years 1942 and 1943 as co-partners of the Trepte Construction Co., pursuant to the Articles of Co-partnership dated January 1, 1942, which come within the provisions of Sections 181, 182, 183, 187, and 3797 of the Internal Revenue Code, and Sections 29.181-1, 29.182-1, 29.183-1, and 29.187-1 of the United States Treasury Department Regulations 111; and

Whether the assignment made by Walter Trepte of the community property consisting of assets, property, business, and earnings in and to the Golden & Trepte Construction Co. is a part of the operations of the Trepte Construction Co.

The petitioners contend that the Articles of Co-partnership of the Trepte Construction Co. entered into as of the first day of January 1942 by and between Walter Trepte and Margaret Trepte, husband and wife, and their two sons, Walter B. Trepte and Albert Eugene Trepte, was a bona fide co-partnership for all purposes, including tax purposes, and that all things necessary and

requisite were done pursuant to the provisions of said Agreement of Co-partnership dated January 1, 1942, to come within the provisions of the Internal Revenue Code Supra and that their individual Income Tax returns should be computed according to the UNITED STATES PARTNERSHIP RETURNS OF INCOME filed for the years 1942 and 1943.

The petitioners further contend that Walter Trepte's interest in the Golden & Trepte Construction Company was community property of Walter Trepte and his wife, Margaret Trepte, and that under the provisions of the Articles of Co-partnership dated January 1, 1942, any income from the Golden & Trepte Construction Company was definitely a source of income to the Trepte Construction Co. and that such income reported in the UNITED STATES PARTNERSHIP RETURN OF INCOME was income of the Trepte Construction Co.

The Tax Court of the United States denied the petitioners' contention and held that the Articles of Co-partnership dated January 1, 1942 (Exhibit 1) were ineffective for income tax purposes and found deficiencies in taxes against Walter Trepte and Margaret Trepte, and in view of the conclusion, made no determination as to the assignment of the interest of Walter Trepte in and to the Golden & Trepte Construction Company to the Trepte Construction Co., Co-partnership, pursuant to agreement dated January 1, 1942 (Exhibit 1).

Code and Regulations

The code and regulations involved in this case are found in the Appendix, *infra*.

Statement

Opening statements were made on behalf of petitioners and on behalf of respondent, after which the

witnesses, at the request of respondent's counsel, were excluded from the room while not testifying.

By STIPULATION OF FACTS by the parties, Exhibits 1, 2-A, 3-B, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17-C, 18-D, 19-E, 20-F, and 21 were introduced and received in evidence; respondent's Exhibits G, H, I, J, K, and L were also introduced and received in evidence.

Synopsis of Exhibits

Exhibit 1: The ARTICLES OF CO-PARTNERSHIP, dated January 1, 1942, between Walter Trepte, Margaret Trepte, Walter B. Trepte and Albert Eugene Trepte, who thereby agreed to become partners with 26% interest in each of Walter Trepte and Margaret Trepte and 24% interest in each of Walter B. Trepte and Albert Eugene Trepte.

Walter Trepte conveyed to the partnership all of his office equipment, planing mill equipment, trucks, machinery, cash in bank, accounts receivable, Naval Air Station job equity, being an equity in the partnership assets of Golden & Trepte Construction Company, and all other personal property used by him in his business, as well as all good will of the business, subject to all liabilities as of January 1, 1942, as appeared on his books, condensed as follows:

Cash, Accounts Receivable; Work in Progress; Building Material; and Fixed Equipment less depreciation	\$89,734.05
Naval Air Station job equity	88,458.88
Total Assets	\$178,192.93
Less: Accounts and Notes Payable and Reserve	53,438.04
	<hr/> \$124,754.89

These assets were the community property of Walter Trepte and Margaret Trepte and were thereby converted into separate property.

Walter B. Trepte and Albert Eugene Trepte each gave to Walter Trepte and Margaret Trepte his note dated January 1, 1942, for \$29,941.17, with interest at 3% per annum, for his 24% interest in the net assets of \$124,754.89, all distribution of proceeds to be applied on the balance of the notes unpaid before distribution to them individually.

Joint Exhibit 2-A: The United States Partnership Return of Income, Form 1065, for the calendar year 1942, Trepte Construction Co., shows ordinary net income of \$176,415.67 and capital gains of \$1,992.42, and the partners' share of income as follows:

Name of each partner	Ordinary net income	Net long-term gain
Walter Trepte	\$ 60,822.35	\$ 686.93
Margaret Trepte	57,054.46	644.37
Walter B. Trepte	29,529.06	333.49
Albert E. Trepte	29,009.80	327.63
	<u>\$176,415.67</u>	<u>\$1,992.42</u>

Joint Exhibit 3-B: The United States Partnership Return of Income, Form 1065, for the calendar year 1943, Trepte Construction Co., shows ordinary net income of \$118,030.00 and capital gains of \$1,550.01, and the partners' share of income as follows:

Name of each partner	Ordinary net income	Net long-term gain
Walter Trepte	\$ 44,467.92	\$ 584.05
Margaret Trepte	24,980.04	327.98
Walter B. Trepte	25,523.78	335.11
Albert E. Trepte	23,058.26	302.87
	<u>\$118,030.00</u>	<u>\$1,550.01</u>

Exhibit 4: The August 23, 1946 deficiency letter together with statement to Walter Trepte shows a deficiency of \$23,183.84.

Exhibit 5: The August 23, 1946, deficiency letter, together with statement to Mrs. Margaret Trepte shows a deficiency of \$29,480.82.

Exhibit 6: Declaration of Emancipation of Minor executed by Walter Trepte and Margaret Trepte April 18, 1942, emancipated their son Albert Eugene Trepte, from parental control as of January 1, 1942, and granted to him the right to control and receive his own earnings and to have all the rights of an adult person.

Exhibit 7: Declaration by Albert Eugene Trepte dated April 22, 1947, to the Trepte Construction Co. declared that he became twenty-one years of age on September 8, 1946, and that he thereby ratified and confirmed his acts as a minor in executing the Articles of Co-partnership as of January 1, 1942, and entering in the business of the partnership.

Exhibit 8: The promissory note of Albert Eugene Trepte dated January 1, 1942, payable to Walter Trepte and Margaret Trepte for \$29,941.17, which shows the various payments endorsed thereon, and fully paid with interest by December 29, 1945.

Exhibit 9: The promissory note of Walter B. Trepte dated January 1, 1942, payable to Walter Trepte and Margaret Trepte for \$29,941.17, shows the various payments endorsed thereon, and fully paid with interest by December 29, 1945.

Exhibit 10: Payroll records of payments to Walter B. Trepte on the payroll sheets of Walter Trepte, Builder, for the weeks or periods for 1935 and 1936.

Exhibit 11: The employees' account records (Compensation Record) of Walter Trepte, Builder, shows em-

ployee Walter B. Trepte—record of employment for each of the pay periods for the years 1937, 1938, 1939, 1940 and 1941.

Exhibit 12: Employees' account record (Compensation Record) of Walter Trepte, Builder, shows employee Albert Eugene Trepte—record of employment for the years 1941 and 1942.

Exhibit 13: Ledger sheets of the Trepte Construction Co. books of account, account No. 293, "Walter B. Trepte—Withdrawals" for the period beginning in 1942 and ended September 26, 1947, shows the details of the withdrawals made by Walter B. Trepte for the payment of the note and interest for the purchase of his 24% share in the Trepte Construction Co., Collector of Internal Revenue for U. S. Individual Income Taxes, Franchise Tax Commissioner for California Individual Income Taxes and other personal expenditures. A summary of the said account is as follows:

Errata Page 7 Trepte vs. Commissioner, Brief for the Petitioners.

YEAR	NOTE AND INTEREST	COLLECTOR OF INTERNAL REVENUE	FRANCHISE TAX COMMISSIONER	OTHER PERSONAL EXPENDITURES	TOTAL
1942			\$ 530.97	\$ 530.97	530.97
1943	\$11,554.74	\$14,036.58	\$1,164.58	2,651.15	29,407.05
1944	10,529.78	6,682.24	446.88	4,984.81	22,643.71
1945	10,463.27	1,740.59	104.38	2,964.41	15,272.65
1946		24,827.76	638.46	3,697.78	29,164.00
To Sept. 26, 1947		6,727.80	648.21	1,745.29	9,121.30
Total	\$32,547.79	\$54,014.97	\$3,002.51	\$16,574.41	\$106,139.68

Exhibit 14: Ledger sheets of the Trepte Construction Co. books of account, account No. 294, "Albert Eugene Trepte—Withdrawals" for the period beginning in 1942 and ended September 3, 1947 shows the details of the withdrawals made by Albert Eugene Trepte for the payment of the note and interest for the purchase of his 24% share in the Trepte Construction Co., Collector of Internal Revenue for U. S. Individual Income Taxes, Franchise Tax Commissioner for California Individual Income Taxes and other personal expenditures. A summary of the said account is as follows:

YEAR	NOTE AND INTEREST	COLLECTOR OF INTERNAL REVENUE	FRANCHISE TAX COMMISSIONER	OTHER PERSONAL EXPENDITURES	TOTAL
1942					
1943	\$11,554.74	\$12,413.21	\$ 987.11	\$ 755.00	\$25,710.06
1944	10,529.78	5,302.29	346.76	467.88	16,646.71
1945	10,463.27	52.23	55.65		10,571.15
1946		20,110.97	428.77	686.23	21,225.97
To Sept. 3, 1947		4,800.55	417.13	794.80	6,012.48
Total	<u>\$32,547.79</u>	<u>\$42,679.25</u>	<u>\$2,235.42</u>	<u>\$2,703.91</u>	<u>\$80,166.37</u>

Exhibit 15: Ledger sheets of the Trepte Construction Co. books of account, account No. 283, "Walter B. Trepte, Capital," shows his 24% interest in the partnership at the

outset and his accumulated capital from the income after withdrawals, the explanation of which is as follows:

24% share in partnership (Trepte Construction Co.) acquired by purchase January 1, 1942..... \$29,941.17

December 31, 1942 Partner's share of income:

Ordinary net income..... \$28,998.09

Ordinary net income—salary
adjustment 530.97

Net long-term capital gain.... 666.98

Total \$30,196.04

Less: Withdrawals 530.97

Balance added to capital.... 29,665.07

Capital—December 31, 1942..... \$59,606.24

December 31, 1943 Partner's share of income:

Ordinary net income..... \$22,993.78

Ordinary net income—salary
adjustment 2,530.00

Net long-term capital gain.... 670.22

Total 26,194.00

Less: Withdrawals 29,407.05

Balance, decrease of capital -(3,213.05)

Capital—December 31, 1943..... \$56,393.19

December 31, 1944 Partner's share of income:

Ordinary net income..... \$ 7,386.44

Ordinary net income—salary
adjustment 4,800.00

Net long-term capital gain 950.12

Total \$13,136.56

Less: Withdrawals 22,643.71

December 31, 1945 Partner's share of income:

Ordinary net income.....\$25,226.09

Ordinary net income—salary

adjustment 4,800.00

Net long-term capital gain 163.20

Total\$30,189.29

Less: Withdrawals 15,272.65

Balance added to capital 14,916.64

Capital—December 31, 1945.....\$61,802.68

December 31, 1946 Partner's share of income:

Ordinary net income.....\$24,844.45

Ordinary net income—salary

adjustment 4,800.00

Net long-term capital gain.... 222.90

Total\$29,867.35

Less: Withdrawals 29,164.00

Balance added to capital..... 703.35

Capital—December 31, 1946.....\$62,506.03

Summary

24% share in partnership acquired by pur-

chase January 1, 1942.....\$29,941.17

YEAR	PARTNER'S SHARE		
	OF INCOME	WITHDRAWALS	DIFFERENCE
1942	\$30,196.04	\$ 530.97	\$29,665.07
1943	26,194.00	29,407.05	-(3,213.05)
1944	13,136.56	22,643.71	-(9,507.15)
1945	30,189.29	15,272.65	14,916.64
1946	29,867.35	29,164.00	703.35
	<u>\$129,583.24</u>	<u>\$97,018.38</u>	<u>\$32,564.86</u>

Net addition to capital account of

Walter B. Trepte..... 32,564.86

December 31, 1946—

Walter B. Trepte—Capital.....\$62,506.03

Exhibit 16: Ledger sheets of the Trepte Construction Co. books of account, account No. 284, "Albert Eugene Trepte, Capital," shows his 24 % interest in the partnership at the outset and his accumulated capital from the income after withdrawals, the explanation of which is as follows:

24% share in partnership (Trepte Construction Co.) acquired by purchase January 1, 1942 \$29,941.17

December 31, 1942 Partner's share of income:

Ordinary net income.....\$29,009.80

Net long-term capital gain..... 655.27

Total\$29,665.07

Less: Withdrawals None

Balance added to capital..... 29,665.07

Capital—December 31, 1942..... \$59,606.24

December 31, 1943 Partner's share of income:

Ordinary net income.....\$23,058.26

Net long-term capital gain..... 605.74

Total\$23,664.00

Less: Withdrawals 25,710.06

Balance, decrease of capital..... -(2,046.06)

Capital—December 31, 1943..... \$57,560.18

December 31, 1944 Partner's share of income:

Ordinary net income.....\$ 7,733.02

Net long-term capital gain..... 603.54

Total\$ 8,336.56

Less: Withdrawals 16,646.71

Balance, decrease of capital -(8,310.15)

Capital—December 31, 1944..... \$49,250.03

December 31, 1945 Partner's share of income:

Ordinary net income.....\$25,226.08

Net long-term capital gain.. 163.20

Total\$25,389.28

Less: Withdrawals 10,571.15

Balance added to capital.. 14,818.13

Capital—December 31, 1945..... \$64,068.16

December 31, 1946 Partner's share of income:

Ordinary net income.....\$24,844.45

Net long-term capital gain.. 222.90

Total\$25,067.35

Less: Withdrawals 21,225.97

Balance added to capital.... 3,841.38

Capital—December 31, 1946 67,909.54

Summary

24% share in partnership acquired by purchase January 1, 1942.....

\$29,941.17

YEAR	PARTNER'S SHARE OF INCOME	WITHDRAWALS	DIFFERENCE
1942	\$29,665.07	None	\$29,665.07
1943	23,664.00	\$25,710.06	-(2,046.06)
1944	8,336.56	16,646.71	-(8,310.15)
1945	25,389.28	10,571.15	14,818.13
1946	25,067.35	21,225.97	3,841.38
Total	\$112,122.26	\$74,153.89	\$37,968.37

Net addition to capital account of

Albert E. Trepte..... 37,968.37

December 31, 1946—

Albert E. Trepte—Capital.....\$67,909.54

Joint Exhibit 17-C: 1942 United States Individual Income Tax Return of Walter Trepte shows the amount he received from the Trepte Construction Co. partnership as ordinary net income \$60,822.35 and from net gain from sale of capital assets \$686.93.

Joint Exhibit 18-D: 1943 United States Individual Income Tax Return of Walter Trepte shows the amount he received from the Trepte Construction Co. partnership as ordinary net income \$44,467.92, and from net gain from sale of capital assets \$584.05.

Joint Exhibit 19-E: 1942 United States Individual Income Tax Return of Margaret Trepte shows the amount she received from the Trepte Construction Co. partnership as ordinary net income \$57,054.46, and from net gain from sale of capital assets \$644.37.

Joint Exhibit 20-F: 1943 United States Individual Income Tax Return of Margaret Trepte shows the amount she received from the Trepte Construction Co. partnership as ordinary net income \$24,980.04, and from net gain from sale of capital assets \$327.98.

Exhibit 21: Certificate of Fictitious Name of the Trepte Construction Co. shows the owners as the four partners named in the Agreement of Co-partnership dated January 1, 1942, which was recorded May 12, 1942, in the office of the County Clerk of the County of San Diego, also Publication was made and Affidavit of Publication was filed June 12, 1942, with the County Clerk of the County of San Diego as provided by the Civil Code of California, Section 2466.

Respondent's Exhibit G: 1942 United States Individual Income Tax Return of Walter B. Trepte shows the amount he received from the Trepte Construction Co. partnership as ordinary net income \$29,529.06, and from net gain from sale of capital assets \$333.49.

Respondent's Exhibit H: 1943 United States Individual Income Tax Return of Walter B. Trepte shows the amount he received from the Trepte Construction Co. partnership as ordinary net income \$25,523.78, and from net gain from sale of capital assets \$335.11.

Respondent's Exhibit I: 1942 United States Individual Income Tax Return of Albert Eugene Trepte shows the amount he received from the Trepte Construction Co. partnership as ordinary net income \$29,009.80, and from net gain from sale of capital assets \$327.63.

Respondent's Exhibit J: 1943 United States Individual Income Tax Return of Albert Eugene Trepte shows the amount he received from the Trepte Construction Co. partnership as ordinary net income \$23,058.26, and from net gain from sale of capital assets \$302.87.

Respondent's Exhibit K: Navy Department Bureau of Yards and Docks, Contract NOY-4205, dated July 6, 1940, (cost-plus-a-fixed-fee) with M. H. Golden and Walter Trepte, called the Contractors. Excerpts from the said contract are as follows:

"TIME OF COMPLETION. ARTICLE 6.—The Contractors agree to proceed immediately with the organization of office and field forces to be engaged upon the work under this contract and to direct their efforts toward early purchases and transportation of materials and the initiation of actual construction work on the site; and to concentrate upon rapid progress and the completion of the entire work at the earliest possible date.

"PLANT AND EQUIPMENT. ARTICLE 7.—The Contractors shall provide all plant and equipment required for the accomplishment of the work under this contract, * * *

"SERVICES AND LABOR. ARTICLE 8.—(a) All services and labor, including personal services of every character, * * *

"MATERIALS. ARTICLE 9.—(a) All materials required for the accomplishment of the work under this contract shall be provided by the Contractors, including materials, articles, and supplies required for temporary use and such as may be consumed in use. * * *

"TERMINATION OF CONTRACT. ARTICLE 13.—(a) Should the Contractors at any time refuse, neglect, or fail to prosecute the work with promptness and diligence, * * *

"RECORDS AND ACCOUNTS. ARTICLE 23.—The Contractors agree to keep accurate records and books of accounts, on a job-order basis, * * *

"PAYMENTS TO THE CONTRACTORS. ARTICLE 26.—The Government agrees that the Contractors may submit at intervals of not less than seven calendar days payment requisitions accompanied by duly certified and approved payrolls, invoices, bills or other substantiating documents, * * *"

Respondent's Exhibit L: Contract on a cost plus a fixed fee, dated June 30, 1942, between Rohr Aircraft Corporation, a California corporation, acting for and on behalf of the Defense Plant Corporation, and Walter Trepte and M. H. Golden individually, doing business as the Golden & Trepte Construction Company, hereinafter called "Engineer-Contractor." The total estimated cost of the contract was \$644,339.00, exclusive of Engineer-Contractor's fee. It was estimated that the work as provided for in the contract would be ready

for utilization by the owner on or before October 15, 1942.

Statement from Oral Evidence

Walter B. Trepte, the elder son of the petitioners, testified that he was twenty-nine years of age and had lived in San Diego, California all of his life and attended grammar school, high school and college there. (Tr. 75);

That he worked for his father in the construction business during the summer of 1935, two months of 1936, during the fall of 1938, all of 1939, and July and August of the year 1940, and to the end of the year 1940 for Golden & Trepte Construction Company, during the year 1941 he worked for Golden & Trepte Construction Company in the timekeeping department where he was in charge of personnel and timekeeping, did some of the bookkeeping and took care of certain security work that the Navy requested and did all of the hiring and firing of the men. (Tr. 76, 77).

As of January 1, 1942, Walter B. Trepte became a co-partner of the Trepte Construction Co. pursuant to Articles of Co-partnership Exhibit 1. The formation of the Co-partnership was discussed with his father and mother, and brother Gene (Albert Eugene Trepte), during the fall of 1941. The object of the formation of the Co-partnership was to carry on the business of the Trepte Construction Co. in the event that his father should meet with a tragedy. During the fall of 1941, his father was making many hazardous trips by airplane, in connection with his construction work. (Tr. 77, 78, 91-93, 154, 155).

Although Walter B. Trepte worked on jobs of the Trepte Construction Co., the Rohr Aircraft Corporation, and the Golden & Trepte Construction Company, all of his services were for and in behalf of the Trepte

Construction Co. and any salary or remuneration he may have received on the various jobs was given consideration at the time an adjustment of his co-partnership remuneration was made at the end of each year, at which time he received \$4800.00 as remuneration for his services from his co-partnership, the Trepte Construction Co. (Tr. 78-80).

A portion of Walter B. Trepte's 24% share in the net income of the Trepte Construction Co. partnership was withdrawn for his personal use, said withdrawals consisted of numerous items which he identified, such as the payments and interest on his note (Exhibit 9) dated January 1, 1942, payable to Walter Trepte and Margaret Trepte for his purchase of a 24% interest in and to the partnership, Collector of Internal Revenue for his United States Individual Income Taxes, Franchise Tax Commissioner for his California Individual Income Taxes, and other personal expenditures. Many of the checks issued for the said withdrawals were signed by the witness and all of them were drawn on the Trepte Construction Co. bank account (See summary of Exhibit 13). (Tr. 80-83, 87, 89-91, 98-100).

During the fall of 1941 when the discussions took place regarding the formation of the co-partnership, the question of tax reduction or avoidance was never brought up. (Tr. 85, 91-93).

Walter B. Trepte signed checks against the Trepte Construction Co. partnership account, and prior to that time from 1937 on, he was authorized to sign checks for and in behalf of his father, Walter Trepte, Builder, and he hired and fired employees of the Golden & Trepte Construction Company from May of 1941 and also of the Co-partnership of which he was a partner, Trepte Construction Co. These constituted valuable and vital

services to the Trepte Construction Co. (Tr. 100, 101, 163).

ALBERT EUGENE TREPTE, second son of the petitioners, stated that he was twenty-two years old, that he was twenty-one on September 8, 1946; he worked for his father in the construction business in the summer of 1941, in the summer of 1942, he delivered and rustled material, which gave him a chance to get around the jobs and understand what was going on. He also went with his father on estimating jobs and discussed them with him. In 1943 he went to summer school. (Tr. 103, 105).

He was in the service from February 28, 1944 until June 7, 1946. He served in the Western Sea Frontier, Southern Sector, for the Navy aboard a 250 foot schooner patrolling the Guadalupe Patrol six hundred miles off San Diego; he held the rate at first, of First Seaman; having had experience in sailing, he was put in the capacity of Leading Seaman handling sails and docking the ship. He was schooled in the Quartermaster's Department, and as Sailing Master he directed men and officers. (Tr. 104, 109, 110).

Having worked in the construction business with his father, Walter Trepte, it was his desire to learn the practical end of the construction business, and he decided to attend California State Polytechnic College at San Luis Obispo, for a two years course, and was taking architectural engineering, which he finished in the spring of 1948. His father had similar schooling. (Tr. 106).

Upon reaching the age of majority, Albert Eugene Trepte ratified the partnership agreement which was entered into when he was a minor. (Exhibit 7). He had discussed the partnership agreement with his father before January 1, 1942, had given his note (Exhibit 8)

for the purchase price of his share of the partnership and that the note was fully paid in 1945. (Tr. 106, 107).

He identified various items of expenditures which were charged to his withdrawal account, such as the payments and interest on his note (Exhibit 8) dated January 1, 1942, payable to Walter Trepte and Margaret Trepte for his purchase of a 24% interest in and to the partnership, Collector of Internal Revenue for his United States Individual Income Taxes, Franchise Tax Commissioner for his California Individual Income Taxes, and other personal expenditures (See summary of Exhibit 14). (Tr. 107, 108, 112).

His source of income since 1942 was from the Trepte Construction Co. and the Navy. (Tr. 113).

MARGARET TREPTE, one of the petitioners, wife of Walter Trepte, and also one of the partners of the Trepte Construction Co., testified that she married Walter Trepte in 1916 when he was working for his father as an employee in the construction business; he did not own anything at the time they were married; they have lived together ever since as husband and wife and whatever he earned since their marriage was community property. (Tr. 115).

She remembered the discussions in regard to the partnership and taking the boys into it; it was talked about for quite a while in 1940 and 1941, as the boys grew up; she executed the 1942 partnership agreement as one of the partners and knew that at that time she was giving up nearly one-half of her community property; she favored the partnership because her husband was flying a good deal and if anything should happen, there would be somebody to carry on and she wanted it that way. The boys had expressed a preference for that kind of work. (Tr. 115, 116).

In discussing the formation of the partnership there was no discussion about reducing taxes. There was mention of the precedent of Mr. Trepte and his father and their partnership. (Tr. 116).

Before the partnership agreement of January 1, 1942 was executed, she said she read it, knew what it contained, signed, it, knew the provision in regard to any of the partners' selling his interest; that the dealings under the partnership were controlled by the majority holding of the partners and that other than her husband, the partners were her two sons. (Tr. 117).

Eugene talked and planned on going into the construction business with his father, all of his life. He would work for his father in the summertime, and when he was at home on vacation, he would go down to the office; when at home, he looked over the books and would take trips with his father around the jobs. (Tr. 117, 118).

The petitioners were in agreement about the boys going into the co-partnership. (Tr. 121).

WALTER TREPTE stated that he was fifty-four years old, a general contractor, engaged in the business since 1917 and before that in various occupations of the contracting industry; worked for his father, Morris Trepte, before 1917 in San Diego and in that year became a partner with his father, giving him a note for an interest in the partnership, which note was paid out of earnings. (Tr. 121, 122).

His father had previously had a partner by the name of Ed Rambo and the witness bought out his interest. Before becoming such partner he had had schooling of two years of structural design in the California School of Mechanical Arts at San Francisco, from 1910 to 1912. From 1912 to 1917 he worked with his father.

The partnership with his father continued until 1928 when the witness bought out the father, paying cash. From 1928 to 1942 there was no one associated with him in his business, which consists of what is known as commercial construction and some engineering construction. His particular architectural and engineering education gave him definite assistance in that work, enabling him to grasp the fundamentals much faster than if he had not had the training, and he was able to do the engineering work himself on his jobs, whereas others would have had to employ architects. (Tr. 122, 123).

Walter Trepte hoped that his sons would join him in the business and influenced them all he could, particularly in the schooling for Gene (Albert Eugene Trepte) in the Polytechnic school, which was discussed with Gene and which the witness had investigated and recommended. (Tr. 123, 124).

He formed the Trepte Construction Company because of the flying that he had to do to get to offshore Navy jobs and because of the business background. He had gone in with his father and thought it was a good thing for his sons to do likewise. On one of the earlier trips to San Clemente Island with Mr. Golden they had a near crash in landing in a fog and discussed the question of what would become of that particular fixed contract with the Navy in case of the death of one or both of them. Witness told Mr. Golden that he had been considering having the boys go into partnership with him and thought that he should form a partnership as soon as he could to carry on the business if anything happened to him. The same line of thought was suggested to him by a government man; Officer Montgomery or Henry B. Smith, while riding in a plane to San Clemente Island, agreed that it would be a very involved matter in case

of accident and if anything happened to the witness. Witness went to San Clemente Island about once a week travelling by air north to Oceanside to a controlling station, then westerly to San Clemente Island. The time of this discussion of the forming of a partnership must have been in the summer of 1941 when they started the San Clemente Island job NOY-4205, Bureau of Public Works, U.S.N. (Tr. 124, 125, 154).

The original contract was for \$2,700,000.00, mostly on North Island in San Diego Bay, which contract had to be completed in about a year's time. The contract was then extended to include Brown Field on the lower end of San Diego Bay, Otay Mesa Airfield facilities, Kearney Mesa Airfield facilities and San Clemente Airfield facilities. The compensation for the work under this contract was paid on a fixed fee basis determined by the officer in charge. The original fee was in the neighborhood of 3 %, paid from the Bureau of Public Works in Washington or the Bureau of Yards and Docks in Washington, he didn't know which; payments were made in installments; the final payment was not determined until the termination of the contract. Payments for labor and material were originally made monthly, then as the job became larger they were made bi-monthly and finally weekly. In order to obtain payments the paid bills and cancelled checks were sent to the Government. The contract eventually ran into between \$21,000,000.00 and \$22,000,000.00. The fee for the first \$2,000,000.00 job was about 3 %, which was reduced later to whatever the Bureau of Yards and Docks agreed to, becoming smaller and smaller. (Tr. 125-127).

After the talk with Mr. Golden, witness discussed the partnership with his family in the fall of 1941. He explained to the boys the advantage of their being taken in

as partners; he had had that experience himself and he found what a big advantage it was to take over a reputation for ability and integrity that you don't have to sweat for yourself, and the boys were able to see and appreciate it; they were questioned about their wishes, and wanted to go into the partnership, (Tr. 127, 128).

There was no discussion about avoiding or reducing taxes at the time of forming the co-partnership. (Tr. 128).

When the partnership was made, Walter B. Trepte was sufficiently educated in the business to take responsibility. He could take care of the office and accounting, do the hiring and the personnel end of the work. He was assistant manager.

The item "Naval Air Station job equity \$88,458.88" set out under the caption "Assets" in the partnership agreement was working capital and money owed to him for labor and material; none of it was profits on the job. (Tr. 130, 152, 153).

Walter B. Trepte had been working for Walter Trepte off and on since 1935; he was personnel man for the partnership and signed checks. (Tr. 130, 131).

After the partnership was formed, there were adjustments made by the partners as to a drawing account to equalize the different earning capacity of the partners. The amount that Walter B. Trepte drew was around \$4,800.00 or \$5,000.00 a year, and Walter Trepte, the petitioner, drew \$20,000.00 a year, except in 1944 when the business was slow and he drew \$10,000.00. Those salaries mentioned were deducted before figuring the profits to be divided between the partners. After the partnership was formed, the boys had the right to withdraw any partnership funds for their own use and did withdraw. (Tr. 131, 132).

At the time the partnership was formed Albert Eugene Trepte had shown an aptitude for the construction business. He had natural ability to handle men and had an interest in the engineering end of the business. Witness thought he had exceptional ability so far as being able to get business, which is a big factor in the work; when the partnership was formed he had shown definite interest in what jobs were doing, what the costs of the jobs were and always showed an interest in the number of jobs—where they were and how they were progressing. He had gone to the jobs with the witness and on questioning had said that he went there to enlighten himself. He entered into discussions as to the character of the job and how it could be handled. (Tr. 132, 133).

Witness identified his signature and that of his wife to Exhibit 6 (Declaration of Emancipation of Minor) dated April 18, 1942. He stated that he had never collected or used any part of Gene's earnings and never paid any of his expenses or school expense; they were drawn by Gene out of his share of the partnership. (Tr. 133).

The petitioners have a child other than the two boys who are partners—a daughter—who was not considered in talking of the partnership, as they did not feel that she would lend any benefit to the partnership. (Tr. 134).

Other than the Navy Air Station job NOY 4205 there were other government jobs that he was doing between 1940 and the end of the war, among them the fuel depot job at San Diego, the defense plant job at Rohr Aircraft Company in Chula Vista, the sea water tunnel job for the San Diego Gas & Electric Company, which the witness thought the government was backing, and several jobs for Ryan Aeronautical Company; the Navy paid for one of the Ryan jobs and the Defense Plant Corporation for the other. The water tunnel job ran about

\$300,000.00, the Navy Fuel Depot job \$750,000.00, the Rohr Defense Plant job close to \$1,000,000.00, and Ryan close to \$1,000,000.00. The Ryan job was taken under Trepte Construction Company and the Fuel Depot and tunnel and one of the Rohr Aircraft jobs by Golden & Trepte Construction Company. (Tr. 134, 135).

On or about January 1st, 1942, he had around 75 to 100 employees. In the Naval Air Station work the Golden & Trepte Company was employing at the peak 1,500 men. (Tr. 135, 136, 141, 152).

Walter B. Trepte had additional responsibility in connection with the Naval Air Station job. First, he was with the timekeeping department, then assistant personnel man, then equipment manager, toward the end of the contract when they were having hurdles at the job and immediately had to get very large amounts of equipment, particularly rental equipment, he supervised the procurement of the material as a representative. (Tr. 136).

The Trepte Construction Company is still continuing as a going partnership. There were no plans to change it in the future. (Tr. 137).

When asked concerning his employment by and partnership with his father in the previous years, as to what kind of business it was, he replied that it was the same business—construction business; that the father started in San Diego in 1895, doing commercial contracting and engineering contracting; building construction is commercial buildings in particular, building factories and warehouses; engineering contracting is usually road work, bridges or waterfront work; in every case it requires, for the purpose of submitting bids, a knowledge of and skill in engineering and construction engineering and labor, materials and prices. (Tr. 137, 138).

His father's former partner was Edward L. Rambo. Witness bought his interest in 1917, giving his father a note for one-half of the business. Rambo left the business and the witness came in his place. He had been working as Superintendent for his father and Rambo at that time. In 1917 he was twenty-four years of age and had been working for his father since 1915. (Tr. 138, 139).

In 1928 he bought his father's interest in the business for cash. There was a division of property and a cash adjustment; they naturally had accumulated some real estate in the business transactions. The father took the bulk of the real estate and an adjustment was made in cash. (Tr. 140).

Walter B. Trepte purchased additional or new equipment in connection with the NOY 4205 job. (Tr. 143).

Asked if it was not a fact that his son, Walter B. Trepte, had never shown any real interest in the business, at least from its technical aspects and engineering features, he replied, "I would not say that. He certainly shows an interest in the operation of the business. His inclination is toward the accounting and the office end of it and the equipment end of the business." (Tr. 153).

Walter B. Trepte was competent to carry on the contracts in the event of the death of Walter Trepte. (Tr. 156).

Walter B. Trepte had helped prior to January 1, 1942 and also subsequent thereto to assemble data necessary for the preparation and submission to the government, concerns and persons, bids for construction work. (Tr. 156, 157).

The family partnership arrangement originated with discussions of his wife and himself (Walter Trepte) for years previous; he had had the same sort of partnership with his father; his father had been able to build up the

good will and integrity of the business prior to the time Walter Trepte was taken in as a partner and up to the time he bought his father out. Witness stated that he kept the good will and integrity of the business and felt that it should be continued by taking in his sons who were able to become partners. (Tr. 157, 158).

The matter of the partnership had never been discussed with any attorney or any accountant prior to the time that it was decided to go through with the plan. (Tr. 159).

Mr. Stone was consulted the latter part of 1941. Mr. Trepte could not say the exact day the actual document was drawn up, but it was around the first of the year. Walter Trepte told the attorney (Mr. Stone) the substance of the provisions wanted in the agreement. Mr. Stone had been his father's and his attorney prior to 1941, had handled the dissolution of the partnership with his father in 1928, but had nothing to do with the transaction whereby he bought out the interest of Rambo in 1917. There was no attorney then; there were not enough assets to pay for an attorney. (Tr. 159, 160).

It was Walter Trepte's purpose that his wife and two sons should carry on the business if anything happened to him; that his older son was trained and had the ability. (Tr. 161, 162).

The Navy contract on North Island was not made on a bid, but was negotiated between Commandant of the Eleventh Naval District, together with the Public Works Officer, to handle a given amount of construction work at North Island; Trepte & Golden did not apply for the job; the Government applied to them. (Tr. 164, 165).

Walter B. Trepte went out of the state to procure equipment in connection with the North Island job; it was a large procurement of several hundred thousand dol-

lars worth of equipment out of the CCC camps at that time in the state of Arizona. It was a transaction between the navy and the CCC authority. He was picked for that job by the officer in charge and did it satisfactorily. (Tr. 165).

The Court inquired of Walter Trepte what consideration had been given in forming partnership agreement with reference to the escape of taxes, and was informed that the tax angle had not been taken into consideration, that the main thing was to have the boys in the business to carry on in case of his death. (Tr. 166, 167).

Specifications of Errors Relied Upon

(1) The findings of the Tax Court are not supported by the evidence;

(2) The failure to hold that the ARTICLES of CO-PARTNERSHIP of the Trepte Construction Co., dated January 1, 1942, were effective as of said date and constituted a bona fide partnership for tax purposes;

(3) The failure to find that the petitioner, Margaret Trepte, and each of the sons of the said petitioner, Walter B. Trepte and Albert Eugene Trepte, contributed capital to the said co-partnership;

(4) The failure to hold that each of the said sons, Walter B. Trepte and Albert Eugene Trepte, contributed vital services to the co-partnership;

(5) The failure to find that each of the said sons, Walter B. Trepte and Albert Eugene Trepte, had a share in the management and control of the business;

(6) The failure to determine that there was a definite relation between the profits allocated to each partner and the value of the services rendered;

(7) The failure to find that there was no casting about for a legal means of lessening the tax;

(8) The failure to find that the formation of the present co-partnership by and between the members of the Trepte family constituted a bona fide co-partnership for tax and all other purposes of the third generation of the Trepte family who have constantly carried on the integrity and good will of the construction business under the Trepte name;

(9) The failure to find that Walter B. Trepte and Albert Eugene Trepte each had his share of the profits derived from the partnership; each had control of his share of the profits; and each son had the right to withdraw his share of the profits without being hampered by his parents in any way;

(10) The failure to hold that the partnership did all things necessary and requisite to constitute a partnership as provided for by the laws of the State of California, and by the Internal Revenue Code, more specifically Sections 181, 182, 183, 187 and 3797;

(11) The findings of deficiencies for the years 1942 and 1943 in lieu of a determination that there is no income tax due from the petitioners, Walter Trepte and Margaret Trepte, for either of the years in controversy;

(12) The Tax Court of the United States erred in rendering its decisions for respondent. (Tr. 61-63).

Summary of Argument

The ARTICLES OF CO-PARTNERSHIP of the Trepte Construction Co. were made and entered into in good faith as of the first day of January, 1942 by and between Walter Trepte and Margaret Trepte, the petitioners herein, husband and wife, and their two sons, Walter B. Trepte and Albert Eugene Trepte, to conduct, carry on and do business as the Trepte Construction Co., pursuant to the ARTICLES OF CO-PARTNERSHIP,

and it was the purpose and intent of all of the parties to form an actual, real, valid, and bona fide co-partnership for all purposes.

All of the code provisions of the State of California were complied with in the formation of a real, actual, valid, and bona fide co-partnership.

The formation of the Trepte Construction Co., Co-partnership by and between the members of the Walter Trepte family, constitutes the third generation who have consistently conducted and carried on the integrity and good will of the construction business under the TREPTE name for a period of approximately a half of a century.

Each of the sons, Walter B. Trepte and Albert Eugene Trepte, rendered vital and valuable services to the co-partnership; each had his duties to perform in connection with the co-partnership and performed them in an efficient and satisfactory manner and each participated in the management and control of the business.

Shortly before the formation of the Trepte Construction Co., the business of Walter Trepte had extended far beyond any anticipated growth. It was, therefore, necessary for him to have others associated with him, in whom he could place confidence and trust to aid and assist him in carrying on and conducting the business. Naturally, his two sons were the logical persons.

Margaret Trepte's contribution to the co-partnership capital was from her community property. Walter B. Trepte and Albert Eugene Trepte each obtained, by purchase, his co-partnership interest in the Trepte Construction Co. by signing a binding obligation in the form of a note (Exhibits 8 and 9) to obtain his interest and the obligation of each was fully discharged by December 29, 1945. There was no element of gift to the sons.

There was a determination of the value of the services rendered by each of the co-partners before the profits were allocated according to the ownership in the Trepte Construction Co. The equalization was made to Walter Trepte, and Walter B. Trepte, according to the value of the services performed for and in behalf of the co-partnership.

The formation of the Trepte Construction Co. Co-partnership was not originated as a means of tax reduction, avoidance, or making a division of the family income, as the tax angles were not discussed prior to the time that the co-partnership became an actual entity.

Neither, Walter Trepte, father, nor Margaret Trepte, mother, attempted to deprive either of their sons of his share of the profits. Each son had the independent retention of his share of the profits.

There was no gradual change from Walter Trepte, Builder, into the co-partnership as was mentioned in the opinion of the Tax Court (Tr. 49). The change was effective as of the formation of the co-partnership January 1, 1942.

At the time of the formation of the co-partnership, TREPTE CONSTRUCTION CO., Walter Trepte duly assigned to the said co-partnership all of the community property assets, property and business subject to the liabilities which he had used to conduct and carry on the business and operations under the name of Walter Trepte, Builder (Exhibit 1).

Walter Trepte duly assigned to the said co-partnership all of his interest in and to the property, business and earnings of the Golden & Trepte Construction Company which was a one-half interest (Exhibit 1).

Argument

PETITIONERS ARE MEMBERS OF THE TREPTE CONSTRUCTION CO., A CO-PARTNERSHIP, AND ARE ENTITLED TO HAVE THEIR INDIVIDUAL INCOME TAXES COMPUTED ON THE BASIS OF THEIR SHARE OF THE INCOME OF THE CO-PARTNERSHIP AS PROVIDED FOR IN SECTIONS 181, 182, 183, 187, and 3797 OF THE INTERNAL REVENUE CODE.

Such Sections of the Internal Revenue Code (Appendix, *infra*) set forth a procedure by which it is submitted that the amount of income of the respective petitioners should be determined so far as the income from the Trepte Construction Co., a co-partnership, is concerned.

The Tax Court of the United States in the first sentence of its opinion of this case states:

“Factually, the first issue in this case follows the now familiar pattern of family partnerships, and is in many respects similar to *Commissioner v. Tower*, 327 U. S. 280, and *Lusthaus v. Commissioner*, 327 U. S. 293.”

Those two cases are readily distinguishable from the case now before this Court. The question in those cases involved husband and wife partnerships and in both instances not in a community property state. Whereas, the question before this honorable Court involves husband and wife in a community property state, and their two sons, wherein the facts and circumstances are entirely different.

It is contended that the Trepte Construction Co. co-partnership comes within the following definition of partnership:

"*Commissioner vs. Tower*, 327 U. S. 280 at 286, 90 Law Ed. 670 at 675, defines a partnership as follows: 'A partnership is generally said to be created when persons join together their money, goods, labor, or skill for the purpose of carrying on a trade, profession, or business and when there is community of interest in the profits and losses. (Citing *Ward vs. Thompson*, 22 How (US) 330, 333, 334, 16 L. Ed 249-251; *Meehan v. Valentine*, 145 US 611, 618, 36 L. Ed 835, 839, 12 S. Ct. 972.)'

B. W. Graham, 8 BTA 1081, the Board quoted from Chancellor Kent the following definition: 'A contract of two or more competent persons to place their money, assets, labor and skill or some or all of them in lawful commerce or business, and to divide the profits and bear the losses in certain proportions.'"

The Articles of Co-partnership of the Trepte Construction Co. (Exhibit 1) were made and entered into in good faith as of the first day of January, 1942, by and between Walter Trepte and Margaret Trepte, husband and wife, and their two sons, Walter B. Trepte and Albert Eugene Trepte to conduct and carry on the business of the Trepte Construction Co. which had been formerly carried on under the name and style of Walter Trepte, Builder, doing commercial construction, engineering construction, road work, and bridge construction. (Tr. 123). It was the purpose and intent of all of the parties at the time the co-partnership was entered into to form an actual, real, valid, and bona fide co-partnership for all purposes. Only those members of the family which it was considered would be beneficial to the operation and conduct of the business were taken into the co-partnership,

and for that reason the petitioners' daughter was excluded as a member (Tr. 134).

Prior to January 1, 1942, the sons were merely employees of their father, in his business as a contractor and builder, their services could have been terminated at any time, they had no investment in the business and were not liable for any losses sustained by the business. After January 1, 1942, this situation was entirely changed, the sons were co-partners with their father and mother, they had signed notes (Exhibits 8 and 9) which obligated them to a definite liability, they had agreed to share in both the profits and losses of the business, and the success or failure of the business fell upon them equally with the other co-partners. It was through the skill of the father, Walter Trepte, and his two sons, Walter B. Trepte and Albert Eugene Trepte, whom he had educated and trained in the business from the time they were small boys until they came into the business with him, that brought about the success of the Trepte Construction Co.

All things necessary and requisite were done pursuant to the provisions of the Civil Code 2466 of the State of California to qualify as a real, actual, legal, valid, and bona fide partnership in the County of San Diego, State of California, where the principal office of the Company is located (Exhibit 21).

The good will and integrity of the name TREPTE in the contracting and building trade has continued for nearly half a century, Walter Trepte's father started in business in San Diego in 1895 (Tr. 137). Through the period of years the Trepte family has done several contracting jobs for the same corporations or persons, all of which shows reliance and confidence in a job satisfactorily accomplished or done in a proper and workmanlike manner (Tr. 158).

Walter Trepte had a similar partnership with his father who was able to build up good will and integrity and when Walter Trepte succeeded his father in the business, he was able to retain it, and he felt that the same good will and integrity could be continued by taking into the co-partnership his sons. (Tr. 158).

In the case of *W. O. Culbertson, Sr. and Gladys Culbertson v. Commissioner of Internal Revenue* 168 F (2d) 979 the Court said:

“Neither the Constitution, the statutes, nor public policy requires that partnerships between fathers and sons be outlawed or discouraged. The desire of a father in any age or clime, with a business that he cherishes and a son that he loves, to have such son with him in his business and to carry it on when he no longer can, was not rendered an anathema by the *LUSTHAUS* and *TOWER* cases, and aberrations from the salutary rules announced in those cases should not now do so.”

To say that Walter B. Trepte and Albert Eugene Trepte are co-partners with their father and mother for all purposes except for Federal tax purposes would preclude them from obtaining the benefit of the fine reputation and good will of the family tradition of contractors and builders, which was accomplished by their father and grandfather. Under such circumstances they would be required to start anew—all of which is against good sound economic principles.

The services of the two sons were valuable and vital to the operations of the co-partnership:

Walter B. Trepte had much to do with the finances of the co-partnership and as has been shown by the transcript of record one of the contracts, NOY 4205 dated July 6, 1940 (Exhibit K), before it was completed, ran

into figures of approximately \$22,000,000.00. He had charge of equipment (Tr. 143), procured materials, hired and fired workmen, determined procedure in connection with the co-partnership that came under his observation, was looked upon by his father as the one upon whom he could rely for assistance, he was placed in positions of confidence and trust, all of which are a vital and valuable element in connection with the conduct and carrying on of a business the magnitude of the Trepte Construction Co. He was trained to carry on the business if anything should happen to his father (Tr. 162).

Albert Eugene Trepte worked on several of the jobs of the co-partnership. He delivered, procured and rustled material, went with his father on various jobs and discussed the jobs with his father. He had natural ability to handle men, an interest in engineering and being able to obtain business, which is a vital factor in the contracting business (Tr. 132). His education has been channeled from early childhood to engage in the construction business; about the middle of the year 1948, he completed a two year course in architectural engineering in California State Polytechnic College at San Luis Obispo (Tr. 106). His education was of course interrupted from February 28, 1944 to June 7, 1946 while he was serving in the armed forces of the United States.

Each of the sons participated in the control and management of the business. It was the cooperation and coordination of the two sons with their father that brought about the success of the business in obtaining the income which was obtained.

During the fall of 1941 the business of Walter Trepte, Builder, and his venture with Mr. M. H. Golden, as the Golden & Trepte Construction Company had grown beyond all expectations. The time had come when it was

necessary for Walter Trepte to surround himself with persons in whom he could have implicit confidence and trust. His two sons, Walter B. and Albert Eugene had from childhood worked with their father, knew and understood much about his work, they were the natural and logical persons to be associated with him. The government and individuals knew of the integrity and ability of both Mr. Trepte and Mr. Golden and sought after them to accept contracts for large and difficult projects (Tr. 165).

The opinion of the Tax Court appears to be partially based on the theory that Margaret Trepte, one of the petitioners herein, did not contribute capital originating with her; whereas it is clearly shown by the evidence that Walter and Margaret Trepte at the time of their marriage had no property and were at all times since their marriage residents of or domiciled in the State of California, a community property state. Under these circumstances there should be no question regarding her contribution of capital to the co-partnership.

Each of the sons obtained by purchase his co-partnership interest in the Trepte Construction Co. by signing a binding obligation in the form of a note (Exhibits 8 and 9). Each of the said notes was dated January 1, 1942, payable on demand, in the principal sum of \$29,-941.17 with interest at the rate of 3% per annum payable to Walter and Margaret Trepte, the petitioners herein. The sons had fully paid the notes together with interest by December 29, 1945. There was no element of gift involved, as the sons went into debt for their interest in the co-partnership and through their efforts and the efforts of their father and the coordination and cooperation of carrying on the business of the Trepte Construction Co., they were successful in discharging their obligations which they had previously incurred.

Before each co-partner's share of income is determined according to his or her per cent of ownership in the co-partnership there is determined the value of the services rendered by each of the respective co-partners. The additional share of the income of Walter B. Trepte for services rendered to the business was around \$4,800.00 a year, whereas the additional services of his father, Walter Trepte, is \$20,000.00 with the exception of the year 1944 when he received only \$10,000.00 because business had been slow, no additional amounts were allocated to the share of the co-partnership income to Margaret Trepte or Albert Eugene Trepte. (Tr. 80, 131, 132).

There is not one iota of evidence throughout the entire transcript which as much as makes an indication that this co-partnership was formed for the purpose of dividing the family income, reducing or avoiding taxes of any kind whatsoever. There was no mention of income tax or tax consequences in the discussions leading up to the formation of the co-partnership (Tr. 85, 116, 128, 159, 166 and 167).

Each of the sons had his independent retention of his share of the co-partnership which was only restricted until the notes (Exhibit 8 and 9) were fully paid and each exercised his independent right over his share of the profits as shown by their drawing and capital accounts, and neither their father nor their mother, attempted to deprive or hamper in any way the sons' control over their share of the profits.

The Tax Court, in its opinion, stated "Petitioner testified there was a gradual change into a partnership" (Tr. 49). This is an erroneous conclusion, as there was no gradual change over from Walter Trepte, Builder, to the Trepte Construction Co. Walter Trepte testified that the co-partnership did not immediately have new station-

ery printed or new checks, but had a rubber stamp made and over stamped his stationery, checks and records with the "Trepte Construction Co." (Tr. 134). This procedure is not an unusual occurrence and at that particular time stationery was exceedingly difficult to obtain.

All of the community property, assets, property, and business, subject to the liabilities of Walter Trepte, Builder, used to carry on the contracting and construction business, was duly assigned to the Trepte Construction Co. at the outset of the formation of the co-partnership, which assignment is clearly set forth in Exhibit 1.

Prior to the formation of the Trepte Construction Co., Walter Trepte had been conducting a joint venture with M. H. Golden under the name of the Golden & Trepte Construction Company and at the time of entering into the Articles of Co-partnership dated January 1, 1942, he duly assigned to the said co-partnership all of the assets, property and business subject to the liability which he had in the Golden & Trepte Construction Company, which was a one-half interest. His interest in the Golden & Trepte Construction Company was assignable as it was not personal in character. As authority for the proposition of his assignment of his interest in and to the Golden & Trepte Construction Company, we refer to the *Iowa Bridge Co. v. Commissioner*, 29 F (2d) Page 777.

There are numerous cases which sustain the petitioners' position that a co-partnership as in this case made, entered into, and carried on by the co-partners in good faith, constitutes a real, actual and bona fide co-partnership for all purposes and this position is supported by the case of *Thomas A. Walsh, Jr. v. Commissioner of Internal Revenue*,—F. 2d—(1948 Federal Tax Service, Prentice-Hall, Par. 72,635):

"The courts, in reliance upon the decisions of the Supreme Court, hold generally that a good faith partnership not designed for the purpose of channeling the income of one of the partners to other members of his family is valid for tax purposes; and that it is not essential that all members of the partnership shall have contributed services; it is necessary only that each member must in good faith have contributed either capital or services or both, as declared in the Tower case, *supra*.

For some recent cases sustaining the validity of family partnerships for tax purposes and reversing the Tax Court, see *Kent v. Commissioner*, 6 Cir.,—F. 2d—(decided September 27, 1948); *Culbertson v. Commissioner*, 5 Cir., 168 F. 2d 979; *Canfield v. Commissioner*, 6 Cir., 168 F. 2d 907; *Woosley v. Commissioner*, 6 Cir., 168 F. 2d 330; *Weizer v. Commissioner*, 6 Cir., 165 F. 2d 772; *Lawton v. Commissioner*, 6 Cir., 164 F. 2d 380; *Wilson v. Commissioner*, 7 Cir., 161 F. 2d 661; *Durwood v. Commissioner*, 8 Cir., 159 F. 2d 400; *Hartz v. Commissioner*, 8 Cir.,—F. 2d—(decided October 27, 1948); and for appeals from district courts sustaining family partnership contracts see: *Allen v. Knott*, 5 Cir., 166 F. 2d 798; *Arnold v. Schepps*, 5 Cir., 166 F. 2d 821. Recent cases in this court affirming decisions of the Tax Court holding such partnerships invalid for tax purposes are: *Kohl v. Commissioner*, 8 Cir.,—F. 2d—; *Supornick v. Commissioner*, 8 Cir., 150 F. 2d 110 (33 AFTR 1507); and *Doll v. Commissioner*, 8 Cir., 149 F. 2d 239 (33 AFTR 1264).

For the reasons stated above the decision of the Tax Court is reversed."

There are many facts in the case of *Walter J. Runyon v. Commissioner*, 8 TC 350, which are analogous to the proceedings in the case before this Court.

The case of *William F. Fischer v. Commissioner*, 5 TC 507, in many respects bears a similarity to the instant case.

Some of the same problems arose in the case of *Ross B. Hammond v. J. W. Maloney*, Collector of Internal Revenue, Fed. Sup.-Vol. 80 No. 1, 212 (DC Ore. April 21, 1948).

With the exception of a different type of enterprise the case of *W. O. Culbertson, Sr. and Gladys Culbertson v. Commissioner of Internal Revenue*, 168 F (2d) 979 is practically on all fours with the case now before this Court. In the *Culbertson* case the father sold an interest to his four sons who gave their notes therefor, which was held to be valid, a balance of which remaining unpaid on the notes was cancelled as a gift. Such amounts as were paid on the notes of the sons were derived from their share of the profits in the business of cattle raising, whereas in the case now before this Court, no part of the notes of the sons was cancelled, and interest was paid on the said notes which came from their share of the profits of the *Trepte Construction Co.* contracting and building business. In the *Culbertson* case, Mr. W. O. Culbertson gave to his daughter an interest in his own cattle, whereas in the *Trepte* case their daughter was excluded from the co-partnership, as it was felt that she could lend no benefit to the co-partnership. Also, in the *Culbertson* case, the business had been carried on for a period of nearly a quarter of a century, whereas in the instant case, the business has been carried on for nearly a half of a century.

We submit that statements of the Court in the *Culbertson* case actually paraphrase almost identical facts in the

Trepte case and its conclusions drawn are identical with those that must be drawn from the evidence in the Trepte case, quoting:

‘‘It was the purpose and intent of all the parties to form an actual, real, and bona fide partnership between Culbertson and his four sons, with the full expectation and purpose that the boys would, in the future, contribute their time and services to the partnership. We do not consider that it is illegal, income-tax-wise or otherwise, for a partnership to be formed in consideration, or contemplation, of services rendered, or to be rendered, by the partners. The fact that the boys were called into the military service by the United States, as well as the fact that some of them had not, during the tax period, completed their education so as to devote their full time and attention to the partnership is in no wise indicative that the partnership was formed for the purpose of dividing the family income, or for the purpose of income tax savings. The failure by a partner to render service to the partnership or to contribute capital originating in him, is, after all, but a circumstance to be considered in determining the reality or actuality of an alleged family partnership. The failure to do either is not a condition precedent.

There is no evidence but that the partnership was entered into validly and in good faith, * * * that this partnership was entered into without any idea, purpose, or thought of the tax consequences but with the idea of carrying on the breeding of fine Herefords in the traditions of that section of the country. * * *

To conclude in this case that the plan and purpose of an aging father to enlist the interest and services

of his four ranch-reared, experienced, and stalwart sons in the carrying on of his and his partner's life work was not for the partnership's benefit seems to require the exaltation of suspicion over the realities to an extent that the exigencies of the times for tax collection neither deserve nor demand. * * *

It seems that out of the cases of *Lusthaus v. Commissioner*, *supra* and *Commissioner v. Tower*, *supra*—which cases were properly decided on their peculiar facts—a concept has been born and is carefully nurtured by the tax collecting agencies that no partnership is valid—*income-tax-wise*—between members of a family unless the members of the family coming into the partnership actually contribute money or had actually, theretofore, rendered services. Neither statute, common sense, nor impelling precedent requires the holding that a partner must contribute capital or render services to the partnership prior to the time that he is taken into it.

These tests are equally effective whether the capital and the services are presently contributed and rendered or are later to be contributed or to be rendered. Moreover, a partnership is formed to act in the future and not in the past and when it is fully expected, intended, and agreed that the incoming partner will render services to the partnership, the Government should not be heard to say: "I will not recognize you as a partner even though you in good faith entered into it. I took you into the Army to fight a war and you did not perform services for the partnership as you had agreed to do."

The inquiry as to a family partnership for income tax purposes must relate to evidence bearing on the reality, the actuality, and the bona fides of the trans-

action, or the absence thereof. Where the proof conclusively shows that a family partnership was entered into for the benefit of the business and not the purpose of evading, avoiding, or dividing, income taxes, it will be deemed a partnership for income tax purposes even as it is recognized in the law for all other purposes. * * *

We think that the evidence shows conclusively that the partnership here was actual, real, bona fide, and entered into for the benefit of the partnership, with no thought of income taxes and no purpose to evade, divide, or defeat their collection."

We further submit that the evidence shows conclusively that the co-partnership was entered into and carried on in good faith, it was actual, real, and bona fide, and entered into for the benefit of the co-partnership with no thought of income taxes and with no purpose of dividing the family income to evade, divide, or defeat income taxes.

Conclusion

On the basis of the law and facts, it is submitted that the petitioners are entitled to have their individual income and victory taxes computed for the years 1942 and 1943 as co-partners of the Trepte Construction Co. pursuant to the Articles of Co-partnership, which come within the provisions of sections of the Internal Revenue Code as set forth in the Appendix, and that the decisions (Tr. 52 and 53) of the Tax Court of the United States should be reversed wherein it found deficiencies in income and victory taxes for the year 1943 against Walter Trepte in the sum of \$23,183.84 and against Margaret Trepte in the sum of \$29,480.82.

Respectfully submitted

GEORGE H. STONE

Wm. D. MORRISON

Counsel for Petitioners

APPENDIX

Internal Revenue Code:

"SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

"SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

"SEC. 183. COMPUTATION OF PARTNER-SHIP INCOME.

(a) *General Rule.*—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b), (c), and (d).

(b) *Segregation of Items.*—

(1) *Capital gains and losses.*—There shall be segregated the gains and losses from sales or exchanges of capital assets.

(2) *Ordinary net income or loss.*—After excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

(c) Charitable Contributions.—In computing the net income of the partnership the so-called “charitable contribution” deduction allowed by section 23 (o) shall not be allowed; but each partner shall be considered as having made payment, within his taxable year, of his distributive portion of any contribution or gift, payment of which was made by the partnership within its taxable year, of the character which would be allowed to the partnership as a deduction under such section if this subsection had not been enacted.

(d) Standard Deduction.—In computing the net income of the partnership, the standard deduction provided in section 23 (aa) shall not be allowed.

“SEC. 187. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

“SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * *

(2) *Partnership and partner.* — The term “partnership” includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not,

within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization."

United States Treasury Department Regulations III:

SEC. 29.181-1. *Partnerships.* — Partnerships as such are not subject to the income tax imposed by chapter 1, but are required to make returns of income. (See sections 187 and 188). For definition of what the term "partnership" includes, see section 3797(a)(2).

"SEC. 29.182-1. *Distributive share of partners.*—

(a) Each partner is required to include in his return for his taxable year within which or with which the taxable year of the partnership ends, whether or not distributed:

- (1) As part of his gains and losses from sales or exchanges of capital assets held for not more than six months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than six months.
- (2) As part of his gains and losses from sales or exchanges of capital assets held for more than six months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than six months.
- (3) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(b) If separate returns are made by the husband and wife domiciled in a community property State, and the husband only is a member of a partnership, the part of his distributive share of gains and losses from sales or exchanges of capital assets or the part of his distributive share of ordinary net income or ordinary

net loss, which is, or is derived from, community property should be reported by the husband and by the wife in equal proportions. * * *

"SEC. 29.183-1. *Computation of partnership income.*—The net income of the partnership shall be computed in the same manner and on the same basis as the net income of an individual, except that:

- (1) The partnership is required to segregate its gains and losses from sales or exchanges of capital assets. A partnership is not allowed the benefit of section 117 (e).
- (2) The partnership is further required, after excluding all items described in paragraph (1), to compute (a) an ordinary net income which consists of the excess of the gross income over the deductions, or (b) an ordinary net loss which consists of the excess of the deductions over the gross income. * * * Payments made to a partner for services rendered and for interest on capital contributions are not deductible in computing the net income of the partnership, such payments being held to represent a division of partnership profits.

"SEC. 29.187-1. *Partnership returns.*—Every partnership shall make a return of income, regardless of the amount of its net income (see section 3797(a) (2) defining the term "partnership"). The return shall be on Form 1065; shall state specifically the information required to be stated by the return form; shall be filed in according to the instructions contained thereon or issued with respect thereto; and shall be sworn to by one of the partners. Such return shall be made for the taxable year of the partnership, that is, for its annual accounting period (fiscal year or calendar year, as the case may be), irrespective of the taxable years of the partners. (See sections 182 and 183). * * *